

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

July 11, 2002

Legend:

Distributing1 =

Distributing2 =

Controlled1 =

Controlled2 =

C2Sub =

Business A =

Business B =

Business C =

Product X =

Corporation A =

Corporation B =

Target =

Country W =

Country Y =

Continent Z	=
Exchange1	=
Exchange2	=
IP	=
Type A IP	=
Type B IP	=
Technology	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Date 8	=
Date 9	=
Date 10	=
Date 11	=
Year 1	=
Year 2	=
Percentage 1	=
Percentage 2	=
Percentage 3	=
Percentage 4	=
Percentage 5	=

Percentage 6	=
Percentage 7	=
Percentage 8	=
Percentage 9	=
\$A	=
\$B	=
\$C	=
\$D	=
Effective Time	=

Dear

This letter responds to your Supplemental ruling request of April 12, 2002, as revised and restated in your letter of May 9, and further supplemented in your letter of June 6, 2002. Additional information was submitted in your correspondence of June 18, 25, and July 1, 2, 3 and 10, 2002. This letter supplements the prior letter ruling dated September 26, 2001 (PLR-127322-00) (the "Prior Ruling"). The pertinent information submitted in the foregoing correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

Summary of Facts

The Prior Ruling addresses a distribution of Controlled1 by Distributing1 to Distributing2, a contribution by Distributing2 of the Continent Z Business B assets and the Controlled1 stock to Controlled2, followed by a transfer of the Continent Z Business B assets and the Controlled1 stock to C2Sub (a wholly owned subsidiary of Controlled2), an initial public offering ("IPO") of Controlled2 stock, and a distribution by

Distributing2 of the Controlled2 stock pro rata to its shareholders.¹ (The distribution of Controlled1 stock by Distributing1 (the “Internal Distribution”) and the distribution of Controlled2 stock by Distributing2 (the “Public Distribution”) are collectively referred to as the “Distributions.”)

1. In the application for rulings submitted in connection with the Prior Ruling, Distributing2 stated that one of the corporate business purposes to be served by the Distributions was facilitating Controlled2’s issuance of equity in an IPO. Distributing2 has determined that under current market conditions an IPO would not be in the best interests of Distributing2. Instead, Distributing2 has determined that Controlled2 shall undertake the acquisition of Target (the “Acquisition”).

2. Target has been engaged in Business C for more than five years. Target has developed an extensive portfolio of Type A IP, which it customizes and licenses to its customers. At the present time, businesses that develop IP tend to concentrate their efforts in developing either (i) Type A IP (that makes IP useful to manufacturers of Product X) such as that developed by Target, or (ii) Type B IP (that provides Technology for Product X) such as that developed by Business B. The acquisition of Target by Controlled2 will enable Controlled2 to provide customers with an IP product that integrates Type A IP and Type B IP. In addition, by acquiring Target, Business B will avoid the need to expend cash to develop Type A IP similar to that provided by Target.

3. Since Date 11, the only issuances, redemptions or transfers of Distributing2 stock as to which either the seller or purchaser of stock was Distributing2, a corporation which Distributing2 controls (within the meaning of Section 368(c)), or a member of a controlled group of corporations (within the meaning of Section 1563) of which Distributing2 is a member, are as follows:

a. Pursuant to a stock purchase agreement dated Date 2, Distributing2 issued Percentage 1 of its common stock to Corporation A for cash. Such agreement also provided that Corporation A could, contingent on its continued ownership of a certain percentage of Distributing2 stock, appoint two of the seven members of Distributing2’s Board of Directors. Corporation A subsequently increased its ownership of Distributing2, but beginning with Date 3, Forms 13D filed with the Securities and Exchange Commission indicate that Corporation A began to sell portions of its holdings in Distributing2. A Form 13D filed on Date 9 indicates that as of Date 8, Corporation A owned Percentage 2 of the issued and outstanding common stock of Distributing2.

¹The following facts of the Prior Ruling are restated to reflect that Distributing1, a Country Y corporation, was not formed to effectuate the proposed transaction; and that Distributing2 is not a foreign corporation.

b. On Date 4, Distributing2 paid a stock dividend whereby each shareholder received one additional share of common stock of Distributing2 for each share then owned.

c. On Date 5, Distributing2 issued its common stock to shareholders of Corporation B in exchange for approximately Percentage 3 of the issued and outstanding shares of Corporation B. On Date 7, Distributing2 exercised an option to acquire the remainder of the outstanding shares of Corporation B. Distributing2 issued a total of approximately Percentage 4 of its issued and outstanding stock to acquire all of the issued and outstanding stock of Corporation B.

d. Shares of Distributing2 have been issued pursuant to the exercise of stock options issued under stock option plans and employee stock purchase plans of Distributing2 (the “Distributing2 Plans”).

e. Distributing2 has redeemed shares pursuant to its stock repurchase program. All shares repurchased pursuant to Distributing2’s stock repurchase program have been repurchased on the open market.

4. As of the date of the Distributions (“Distribution Date”), each outstanding option to purchase Distributing2 stock granted prior to the Distributions to an employee of Business B who will be employed by Controlled2 or its subsidiaries will be converted into two options: (i) an option (a “Distributing2 Adjusted Option”), which will provide a holder the right to purchase the same number of shares of Distributing2 common stock covered by the options and as to which the option has not been exercised; and (ii) an option (a “Separation Agreement Option”), which will provide a holder the right to purchase a number (determined by formula) of shares of Controlled2. Distributing2 options held by persons who are not employees of Business B will be repriced after the Distributions to reflect the decreased value of Distributing2 after the Distributions.

5. The stock of Distributing2 is listed and actively traded on Exchange 1. The stock of Target is listed and actively traded on Exchange 1 and Exchange 2. After the Distributions and Acquisition, the stock of Controlled2 will be listed on Exchange 1 and Exchange 2.

6. In Date 1, Distributing2 adopted a stockholders’ rights agreement, pursuant to which one preferred share purchase right was distributed to shareholders of Distributing2 in respect of each outstanding share of common stock. No preferred share purchase rights have been exercised.

7. The only issuances of Controlled2 stock since Date 11 were to Distributing2. There have been no redemptions or transfers of Controlled2 stock.

8. On Date 6, Controlled2 adopted the Year 1 Stock Incentive Plan. Pursuant to this plan, Controlled2 has issued options to persons in connection with services rendered by such persons to the divisions of Distributing2 and Distributing1 that conduct Continent Z and non-Continent Z Business B. Such options by their terms cannot be exercised prior to the Distributions.

9. On Date 10, the Board of Directors of Controlled2 authorized the adoption of the Controlled2 Year 2 Employee Stock Purchase Plan. This plan will not be implemented until after the Acquisition.

10. The organizational documents of Controlled2 provide that each holder of stock is entitled to one vote per share on all issues on which the shareholders vote (including the selection of the Board of Directors), and voting is not cumulative.

11. Target has one class of stock. Pursuant to Target's equity compensation plans and other compensatory option arrangements (the "Target Equity Compensation Plans"), including an employee stock purchase plan (the "Target ESPP"), Target has issued stock and options to acquire Target stock (the "Target Share Options"). Certain of the Target Share Options are outstanding. Additional equity-based compensation is provided to certain Country W employees of Target and entities related to Target within the meaning of Section 355(d)(7)(A) by means of distributions on stock of Country W patent holding subsidiaries of Target (the "Patent Holding Companies") purchased (at par value) by such employees (the "Patent Holding Company Compensation Arrangement").

12. Distributing2, Controlled2 and Target agreed as follows:

a. Distributing2 will effectuate Steps I through VI described in the Prior Ruling except that the IPO described therein will not occur. Subsequently, Distributing2 will contribute to Controlled2 for cancellation a certain number of shares of Controlled2 and will then distribute all of the remaining outstanding stock of Controlled2 to shareholders of record of Distributing2. Controlled2 will maintain \$A in cash (less expenses related to the Acquisition of up to \$B) as part of Business B.

b. Immediately prior to the Acquisition, Target will reduce its capital by paying to its shareholders pro rata \$C in cash held by Target or its subsidiaries. Following this payment, Target and its subsidiaries will retain in excess of \$D in cash.

c. Target will terminate the Target ESPP and cancel all rights thereunder prior to the Acquisition.

d. Immediately after the Distributions, Controlled2 will acquire all of the issued and outstanding stock of Target in exchange for an amount of stock not

greater than Percentage 5 of the total issued and outstanding stock of Controlled2. Cash will be paid in lieu of fractional shares of Controlled2 stock.

e. There will be eight directors of Controlled2, consisting of four individuals designated by Target, and four individuals designated by Distributing2. The current Chief Executive Officer and Chairman of the Board of Directors of Distributing2 will serve as the Chairman of the Board of Directors of Controlled2. Upon the resignation, death or removal of any director prior to the first meeting of the shareholders of Controlled2, a replacement director shall be designated by the remaining directors of Controlled2 who were designated by Distributing2, if the former director had been designated by Distributing2, or by the remaining directors of Controlled2 who were designated by Target, if the former director had been designated by Target.

f. Controlled2 will issue a Target Assumed Option in respect of each Target Share Option outstanding at the Effective Time under the Target Equity Compensation Plans (except the Target ESPP), whether vested or unvested. Each Target Assumed Option will constitute an option to acquire, on the same terms and conditions as were applicable under such Target Share Option immediately prior to the Effective Time, stock of Controlled2, provided that the exercise price and number of shares subject to the Target Assumed Option shall reflect the conversion ratio for the Acquisition. The Target Equity Compensation Plans, insofar as they relate to outstanding Target Share Options, shall be assumed by Controlled2.

g. Certain shareholders holding in the aggregate approximately Percentage 6 of Target and certain shareholders owning in the aggregate approximately Percentage 7 of Distributing2 will each enter into a voting agreement with Controlled2 on or before the date of the Acquisition. Each shareholder that enters into a voting agreement will agree to vote (i) with respect to elections for the Board of Directors, for the persons nominated by Controlled2, and (ii) with respect to all other matters voted on by shareholders, either (A) in accordance with the recommendation of the Board of Directors of Controlled2, or (B) if there is no recommendation, for or against any such matter in the same proportion as the shares owned by all other stockholders of Controlled2 (excluding the shareholder itself and any transferee or assignee of the shareholder who is an affiliate of the shareholder) are voted. Each voting agreement will terminate not later than two years after the date of the Acquisition.

13. It is anticipated that there will be one controlling shareholder as defined in Treasury Regulation Section 1.355-7T(h)(3) ("Controlling Shareholder") of Controlled2 immediately after the Acquisition. Such Controlling Shareholder has entered into an agreement providing that he will not enter into any agreement, understanding, arrangement, or substantial negotiations, as such terms are defined in Treasury Regulation Section 1.355-7T(h)(1), concerning a purchase of Controlled2 stock during the one year period following the effective date of the Acquisition, except that he may

accept any option to acquire shares of common stock of Controlled2 that may be granted to him by the Board of Directors of Controlled2 which satisfies the requirements of Treasury Regulation Section 1.355-7T(e)(3)(ii).

14. For purposes of this Ruling: (i) the term "Distributing2 Equity Compensation Plans" shall mean all plans or arrangements including any plans or arrangements to be established in the future, pursuant to which Distributing2 may issue stock, options and other forms of equity as compensation, (ii) the term "Controlled2 Equity Compensation Plans" shall mean all plans or arrangements, including the Controlled2 Year 1 Stock Incentive Plan, the Controlled2 Year 2 Employee Stock Purchase Plan, the Target Equity Compensation Plans (including issuances in respect of the Target Assumed Options), and other plans or arrangements to be established in the future, pursuant to which Controlled2 may issue stock, options and other forms of equity as compensation, and the Patent Holding Company Compensation Arrangement; (iii) the term "Equity Compensation Plans" shall mean the Distributing2 Equity Compensation Plans and the Controlled2 Equity Compensation Plans; and (iv) the term "Stock Repurchase Programs" shall mean any stock repurchase program of Distributing2 or Controlled2.

The following supplemental representations have been made concerning the Proposed Transaction.

1. The Distributions are being carried out for the following corporate business purposes among others: (i) to permit Business B to issue equity interests in its operations to its key employees, and (ii) to allow Controlled2 to acquire Target.

2. Target would not consent to the Acquisition unless the Distributions were completed prior to the Acquisition.

3. The cash that Business B will have after the Distributions is necessary for the conduct and growth of Business B. The cash that Distributing2 will have after the Distributions is necessary for the conduct and growth of the Business A.

4. There were no discussions between the officers, directors or Controlling Shareholders of Distributing2 (or another person or persons with the implicit or explicit permission of one or more officers, directors, or Controlling Shareholders of Distributing2) and: (i) the management of Corporation A (or a person or persons with the implicit or explicit permission of Corporation A) about the Internal Distribution or Public Distribution during the two years prior to the Corporation A acquisitions, or (ii) the management, directors or shareholders of Corporation B (or a person or persons with the implicit or explicit permission of Corporation B) about the Public Distribution during the two years prior to Date 5.

5. All shares of Distributing2 issued since Date 11 pursuant to the Distributing2 Plans were, and all shares to be issued prior to the Distributions will be, issued to persons in connection with the performance of services by such persons as an employee, director or independent contractor for Distributing2, Controlled2, Distributing1, Controlled1, or an entity related to one of such corporations within the meaning of Section 355(d)(7)(A), and were not, or will not be, excessive by reference to the services performed (except that such shares may have been, or may be, issued to transferees of options issued to such employees, directors or independent contractors). Such shares were, or will be, issued in transactions to which Section 83 or Section 421 applied. Distributing2 will not issue any shares prior to the Distribution Date other than pursuant to the Distributing2 Plans.

6. On the Distribution Date, Distributing2 will not have outstanding any option, warrant, convertible, or other right to acquire Distributing2 stock other than (i) stock options and rights granted to persons under the Distributing2 Plans in connection with the performance of services by such persons as an employee, director or independent contractor for Distributing2, Controlled2, Distributing1, Controlled1 or an entity related to one of such corporations within the meaning of Section 355(d)(7)(A) that are not excessive by reference to the services performed, and (ii) the Distributing2 Adjusted Options. All such options and rights outstanding on the Distribution Date will have customary terms and conditions, and immediately after the Distribution Date either the transfer of stock pursuant to such options will be described in Section 421, or such options will not be transferable within the meaning of Section 1.83-3(d) and will not have a readily ascertainable fair market value as defined in Section 1.83-7(b), except that certain options under the Distributing2 Plans may be transferred in the discretion of the plan administrator to family members (within the meaning of Section 267 (c)(4)) (provided that transfers of property optioned thereunder will be subject to Section 83).

7. Regardless of any acquisition of Distributing2 stock made after Date 11 and prior to the Distribution Date, or any future acquisition of Distributing2 stock or Controlled2 stock other than in the Acquisition, both the Internal Distribution and the Public Distribution would have occurred at approximately the same time and in similar form.

8. Immediately after the Acquisition, Controlled2 will not have outstanding any option, warrant, convertible, or other right to acquire Controlled2 stock, other than (i) stock options issued to persons in connection with the performance of services by such persons as an employee, director or independent contractor for Distributing2, Controlled2, Distributing1, Controlled1, or an entity related to one of such corporations within the meaning of Section 355(d)(7)(A) that are not excessive by reference to the services performed, (ii) the Separation Agreement Options, and (iii) the Target Assumed Options. All such options described in (i), (ii) and (iii) outstanding on the Distribution Date will have customary terms and conditions, and immediately after the Distribution Date either the transfer of stock pursuant to such options will be described in Section 421 or such options will not be transferable within the meaning of Section

1.83-3(d) and will not have a readily ascertainable fair market value as defined in Section 1.83-7(b), except that certain options under the option plans of Controlled2 may be transferred in the discretion of the plan administrator to family members (within the meaning of Section 267(c)(4)) (provided that transfers of property optioned thereunder will be subject to Section 83).

9. Immediately prior to the Acquisition, Target will not have outstanding any option, warrant, convertible, or other right to acquire Target stock, other than stock options issued to persons in connection with the performance of services by such persons as an employee, director or independent contractor for Target or an entity related to Target within the meaning of Section 355(d)(7)(A) and were not excessive by reference to the services performed. No other options, rights, warrants or other instruments to acquire stock of Target will be assumed by Controlled2 in the Acquisition. All the Target Assumed Options will have customary terms and conditions, and immediately after the Distribution Date either the transfer of stock pursuant to such options will be described in Section 421 or such options will not be transferable within the meaning of Section 1.83-3(d) and will not have a readily ascertainable fair market value as defined in Section 1.83-7(b).

10. Immediately prior to the Acquisition, current and former employees of Target or an entity related to Target within the meaning of Section 355(d)(7)(A) will own Percentage 8 or less of the total number of outstanding shares of each of the Patent Holding Companies, which shares were issued to each of the holders in connection with the performance of services as an employee of Target or an entity related to Target within the meaning of Section 355(d)(7)(A) and which shares were not excessive by reference to the services performed. Section 83 would apply to any Patent Holding Company shares issued to employees.

11. Immediately prior to the Acquisition, none of the Target Share Options will be held by persons who will be either a Controlling Shareholder, or a 10 Percent Shareholder as defined in Treasury Regulation Section 1.355-7T(h)(9), of Controlled2 following the Acquisition.

12. For one year following the Distribution Date, all stock issued pursuant to Distributing2 Equity Compensation Plans (i) will be issued to persons in connection with the performance of services by such persons for Distributing2, Distributing1, Controlled2, Controlled1, or an entity related to one of such corporations within the meaning of Section 355(d)(7)(A), or will be issued to transferees of such persons, and will not be excessive by reference to the services performed, or (ii) will be issued pursuant to the Distributing2 Adjusted Options. Any such stock issued will be issued in a transaction to which Section 83 or Section 421 applies.

13. For one year following the Distribution Date, all options issued pursuant to the Distributing2 Equity Compensation Plans will be issued to persons in connection

with the performance of services by such persons as an employee, director or independent contractor for Distributing2, Distributing1 or an entity related to such corporations within the meaning of Section 355(d)(7)(A). All such options will have customary terms and conditions and will not be excessive by reference to the services performed. For options granted within one year following the Distributions, either the transfer of stock pursuant to such option will be described in Section 421(a) or upon issuance the options will (i) be nontransferable within the meaning of Treasury Regulation Section 1.83-3(d) (except for limited transferability to the employee's or director's family members within the meaning of Section 267(c)(4) provided that transfers of property optioned thereunder will be subject to Section 83), and (ii) not have a readily ascertainable fair market value within the meaning of Treasury Regulation Section 1.83-7(b).

14. For one year following the Distribution Date, all stock issued pursuant to Controlled2 Equity Compensation Plans except as discussed in 17 below (i) will be issued to persons in connection with the performance of services by such persons as an employee, director, or independent contractor for Distributing2, Distributing1, Controlled2, Controlled1, or an entity related to one of such corporations within the meaning of Section 355 (d)(7)(A) or will be issued to transferees of such persons, and will not be excessive by reference to the services performed, (ii) will be issued pursuant to the Target Assumed Options, or (iii) will be issued pursuant to the Separation Agreement Options. Any such stock issued will be issued in a transaction to which Section 83 or Section 421 applies.

15. For one year following the Distribution Date, all options issued pursuant to Controlled2 Equity Compensation Plans will be issued to persons in connection with the performance of services by such persons as an employee, director or independent contractor for Controlled2, Controlled1, or an entity related to one of such corporations within the meaning of Section 355(d)(7)(A). All such options will have customary terms and conditions, and will not be excessive by reference to the services performed. For options granted within one year following the Distributions, either the transfer of stock pursuant to such option will be described in Section 421(a) or upon issuance the options will (i) be nontransferable within the meaning of Treasury Regulation Section 1.83-3(d) (except for limited transferability to the employee's or director's family members within the meaning of Section 267(c)(4) provided that transfers of property optioned thereunder will be subject to Section 83) and (ii) not have a readily ascertainable fair market value within the meaning of Treasury Regulation Section 1.83-7(b).

16. For the one year period following the Distributions, (i) any stock repurchases made pursuant to a Stock Repurchase Program will meet the requirements of Section 4.05(1)(b) of Revenue Procedure 96-30, and (ii) there will be no agreement, understanding, arrangement or substantial negotiations within the meaning of Treasury Regulation Section 1.355-7T(h)(1) with respect to any Stock

Repurchase Program pursuant to which a repurchase of stock would not meet the requirements of Section 4.05(1)(b) of Revenue Procedure 96-30.

17. For one year following the Distribution Date: (i) all stock issued pursuant to the Patent Holding Company Compensation Arrangement will be nonvoting stock issued to then current employees of Controlled² or an entity related to such corporation within the meaning of Section 355(d)(7)(A) in connection with the performance of services by such persons for Controlled² or an entity related to such corporation within the meaning of Section 355(d)(7)(A), and will not be excessive by reference to the services performed; (ii) Controlled² will only issue to employees an additional number of shares in each of the Patent Holding Companies, which number, when aggregated with the outstanding shares held by employees immediately prior to the Acquisition, will represent no more than Percentage 9 of the total number of outstanding shares of each of the Patent Holding Companies; and (iii) any shares issued will be issued in a transaction to which Section 83 applies.

Based on the facts submitted and representations made herein, we rule as follows:

1. The additional information submitted and representations set forth above will have no adverse effect on the rulings set forth in the Prior Ruling.

2. No gain will be recognized pursuant to Section 355(c) by Distributing¹ on the distribution of Controlled¹, or by Distributing² on the distribution of Controlled², except that no opinion is expressed with respect to transactions occurring after the Acquisition except as provided in Ruling 3 below.

3. The following acquisitions of stock or options to acquire stock after the Acquisition will not be treated as direct or indirect acquisitions of stock that are part of a plan (or related series of transactions) pursuant to which one or more persons acquire directly or indirectly stock representing a 50 percent or greater interest in a distributing or controlled corporation within the meaning of Section 355(e):

A. Acquisitions of stock or options to acquire stock pursuant to the Equity Compensation Plans.

B. Acquisitions of stock pursuant to the Stock Repurchase Programs.

C. Acquisitions of stock pursuant to the Patent Holding Company Compensation Arrangement.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

Section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

Each taxpayer involved in this transaction should attach a copy of this ruling letter to the taxpayer's federal income tax return for the taxable year in which the transaction is consummated.

In accordance with the power of attorney on file in this office, a copy of this ruling letter is being sent to the taxpayer.

Sincerely yours,

Gerald B. Fleming
Senior Technician Reviewer
Branch 2
Office of Associate Chief Counsel
(Corporate)